Testimony of
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Vice President of the National Association
of Home Builders
before the
Senate Committee on Banking, Housing
and Urban Affairs
on
Expanding Homeownership Opportunities

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Introduction

Thank you Mr. Chairman for the opportunity to testify before the Committee on Banking, Housing and Urban Affairs on homeownership barriers and solutions. I am Bobby Rayburn, a home builder and developer from Jackson, Mississippi. My company, Rayburn Associates, has constructed more than 3,000 single and multifamily homes. Expanding homeownership opportunities is, and has been, a major focus of my 30 years in home building. I also serve as the 2003 First Vice President of the 211,000 member National Association of Home Builders (NAHB), which I am here to represent today. NAHB represents more than 800 state and local home builders associations across the country, and NAHB members will build approximately 80 percent of the nearly 1.7 million new housing units that are projected for construction in 2003.

Homeownership is the preferred housing option for most Americans. Surveys consistently put the desire to own one's home at the top of list of life preferences. The latest figures from the Census Bureau confirm that many have been able to accomplish that dream: 68 percent of all households do own their home, up 4 percentage points in the past ten years.

Americans have many reasons for wanting to become and remain homeowners. Home equity is a major and, in most cases, singular source of wealth. According to the latest data from the Federal Reserve, home owner equity totals $13,889 billion and accounts for 35 percent of household wealth. As a comparison, household's holding of corporate equity, i.e. their investment in the stock market, totals $4,166 billion or 11 percent of their worth. The equity in owned homes serves as homeowners' savings for college educations for their children, opening new businesses and retirement. Home equity also provides a financial cushion and source of funds for large expenditures like home remodeling, furnishing and landscaping. Over the past year, Freddie Mac estimates that homeowners extracted $ 166 billion from their homes when they refinanced. This additional consumer spending made a substantial contribution to keeping the economy going and recovering from the 2001 downturn.

Homeownership also has proven positive impacts on the non-financial side of households. Research published in social science and economic journals show that children raised in owned homes have higher test scores and remain in school longer. Other studies show that homeowners are more likely to be active in community affairs, more likely to vote and more likely to socialize with their neighbors. Neighborhoods of homeowners provide positive impacts on the neighborhood through higher maintenance expenditures and lower negative influences.

Building owned homes provides economic stimulus to the communities where they are located and to the economy as a whole. The typical new single family home spawns new economic activity in the community beyond the actual construction. NAHB estimates that the construction impact of building 100 homes and the attendant ripple effects add $11.6 million of economic activity, $1.4 million of new tax and fees to local governments and 250 new jobs. And the ongoing impact from a new household living and spending in the community adds $2.8 million in additional income to the area every year, about one-half million dollars to local government treasuries and 65 jobs.

Barriers to Homeownership

A little less than one-third of all households are renters and many chose renting because it fits their life-style, location preference or family situation. Many would prefer homeownership, but find barriers too large to jump. In addition, roughly 1.2 million additional households are formed every year, and many of these households search for but are unable to find affordable homeownership opportunities.

Barriers to affordability result from two sources: potential home buyers have insufficient savings to make a downpayment and cover the closing costs and/or home prices are too high because of unnecessary layers of restrictions, requirements, delays and other causes of added costs without benefit.

On the financial side, many households find the cash needed for a downpayment and the closing costs significantly exceed their savings. Even with existing programs sponsored by federal agencies, FHA, VA and the RHS, the final downpayment and another two to four percent of the mortgage amount, or more, in closing costs is a very large sum for young families. Programs that reduce upfront costs are the most critical in getting first-time home buyers into housing. NAHB estimates that an extra $1,000 in downpayment assistance would allow 230,000 additional renters to buy a home.

On the regulatory barrier side, homes cost more than they should because local, state and federal governments erect obstacles and add costs that are unnecessary and without sufficient benefit. A large component of the costs are caused by delays and lengthy processing times at the local government level. There also are local policy barriers to affordable housing, including restrictions on multifamily housing, large-lot zoning, density restrictions, excessive impact fees, excessive street-width requirements, building moratoria and residential growth caps, among others.

Federal regulatory actions also add costs without corresponding benefits. For instance the Environmental Protection Agency recently re-opened the designation of isolated wetlands even though a court decision provided sufficient definition. The Fish and Wildlife Service persistently designates very large tracts of land for critical habitat, which eliminates development from these areas and increases the cost of the remaining lands. There are many other examples like these where well-intended efforts to protect the environment or humans have unintended but significant negative impacts on housing, affordability and homeownership.

The U.S. Department of Housing and Urban Development (HUD) as established a new office to serve as a clearing house for efforts to identify and remove barriers to affordable housing. NAHB looks forward to working with this new office in this important effort.

Solutions

NAHB Support for the President's "Blueprint for the American Dream"

NAHB fully supports President Bush and his "Blueprint for the American Dream" initiative to increase homeownership opportunities for minority families. In support of the President's initiative, NAHB has committed to promote homeownership education, improve minority access to credit, and remove barriers to the production of affordable housing.

At the federal level we are pursuing the enactment of a number of legislative proposals that will significantly address both the cost and cash resources barriers to homeownership. These measures include a homeownership tax credit to support the production of affordable homes in underserved areas; a refundable first-time home buyers' tax credit that can help lower upfront cash hurdles; more federal grants to states for downpayment assistance for lower-income home buyers; and, several other initiatives to expand homeownership opportunities. NAHB is also pursuing changes in federal regulations that will increase the incentives of lenders to address homeownership gaps and reduce the costs of federal regulations.

The members of the National Association of Home Builders (NAHB) are committed to removing barriers to homeownership for minority families. Many of NAHB's state and local affiliates have engaged in initiatives to promote minority homeownership. NAHB has been working with its network of state and local affiliates to find markets that could most benefit from education and outreach initiatives. NAHB is also working with other Blueprint partners to identify opportunities for cooperative outreach efforts. NAHB is dedicated to increasing public education regarding the many existing programs -- public and private -- that can help families achieve the dream of homeownership.

NAHB Legislative Priorities

Homeownership Tax Credit

NAHB's top legislative priority in the 108th Congress is the Homeownership Tax Credit (HOTC). The credit was first proposed by the administration and has been included in each of the president's last three budget proposals. Three bills have been introduced in this Congress that reflect the administration's proposal. The bills have more than 20 sponsors in the Senate and 100 sponsors in the House. The first bill introduced in the Senate was S. 198, the "New Homestead Economic Opportunity Act" and was sponsored originally by Senators Gordon Smith (R-OR), Rick Santorum (R-PA) and Debbie Stabenow (D-MI). The second bill introduced in the Senate was S. 875, the "Community Development Homeownership Tax Credit Act" and was introduced by Senators John Kerry (D-MA) along with Senator Rick Santorum (R-PA), Senators Wayne Allard (R-CO), Debbie Stabenow (D-MI), and Paul Sarbanes (D-MD). The House bill is H.R. 839, the "Renewing the Dream Tax Credit Act" and was originally sponsored by Representatives Rob Portman (R-OH), Ben Cardin (D-MD) and Henry Bonilla (R-TX).

NAHB is working with nearly 30 national organizations to support the pending HOTC legislation in the Community Homeownership Credit Coalition. These groups include nonprofit and for-profit developers, state allocating agencies and corporate investors. These groups include the National Council of State Housing Agencies, Fannie May, Freddie Mac, and the National Realtors' Association.

All three HOTC bills provide a tax credit up to 50 percent of the construction or rehabilitation costs of building owner occupied homes in hard-to-develop areas that must be sold to low- and moderate-income buyers. Although NAHB opposes one provision in two of the bills that creates a preferential set aside for nonprofit developers, we support all three bills. We believe that an exceptionally fine HOTC program can be crafted from the proposals during the legislative process that will benefit Americans most in need.

The HOTC is needed to improve the quality of life in distressed neighborhoods through increased homeownership of quality housing. Existing buildings in distressed areas frequently are not renovated because the costs exceed the prices at which the housing units can be sold. Similarly, the costs of new construction may exceed the market values of the homes. Projects will not be built and neighborhoods will remain blighted unless the gap between development costs and market prices can be closed.

The HOTC proposals seek to close the gap in homeownership rates among Americans. While 82 percent of households earning 100 percent or more of the national median income now own homes, only 53 percent of households earning less than the national median are homeowners. The homeownership rate for families earning 80 percent or less of the national median is only 40 percent to 45 percent. Homeownership for whites is 75 percent while the ownership rate for African Americans is just below 48 percent and 48 percent for Hispanics.

According to the U.S. Census Bureau, there are an estimated 34.2 million renter-households in the U.S. but only about 3.5 million of them (10 percent) can afford to buy a modestly priced home, i.e. a home that is less expensive than 75 percent of owner-occupied homes in a given area.

The tax loss estimated by adding the HOTC to the Internal Revenue Code is expected to be $2.5 billion over the first five years and $16.1 billion over 10 years. For that tax expenditure the

HOTC is expected to produce 50,000 new and rehabilitated homes annually, $2 billion of private equity investment, $6 billion in total investment generated, 122,000 jobs, $4 billion in wages, and $2 billion in taxes and fees.

The funding and administration of the HOTC is modeled on the Low-Income Housing Tax Credit (LIHTC) that is used to finance rental properties. Each year a state is eligible for HOTCs of $1.75 per capita, or a minimum of $2 million. The state allocates credits to developers through a competitive allocation process administered by state agencies. A developer can obtain a HOTC for up to 50 percent of the development cost of each home. Developers can sell credits to investors to raise financing for construction or rehabilitation costs. The tax credit is claimed over five years and is not subject to recapture by the developer or investors, or any other obligation after the home is sold to an eligible buyer (generally a family with an income that is 80 percent or less than area median gross income).

The structural difference between the LIHTC and the HOTC is that the HOTC can only be used in distressed areas (location based) while the LIHTC can be used in all areas (income based) to provide housing. The location based HOTC is needed to increase homeownership in low- and moderate-income neighborhoods.

The three pending bills would apply the tax credit to a single-family home containing one to four housing units, a condominium unit, stock in a housing cooperative, modular housing, or manufactured housing. Qualifying residences would be located in a targeted census tract, in a chronic economic distressed area as defined in section 143(j)(3) of the Internal Revenue Code, a reservation for a federally recognized Indian tribe, or in a rural area as defined by section 520 of the Housing Act of 1949. As defined, rural areas mean any open country, or any place, town, village, or city which is not part of or associated with an urban area and which (1) has a population not in excess of 2,5000 inhabitants, or (2) has a population in excess of 2,500 but not in excess of

10,000 if it is rural in character, or (3) has a population in excess of 10,000 but not in excess of 20,000, and (A) is not contained within a standard metropolitan statistical area, and (B) has a serious lack of mortgage credit for lower and moderate-income families, as determined by the Secretary of Agriculture and Secretary of Housing and Urban Development. The basis of the credit should include rehabilitation expenditures (excluding land).

NAHB generally favors giving states the maximum possible latitude in administering the HOTC program. In this regard, NAHB believes that the program will be more efficiently operated if all developers are treated equally at the federal level. The creation of a federally required 10 percent set aside for tax exempt developers in S. 875 and H.R. 839 is an unnecessary intrusion on the states administrative authority. States should be allowed to choose to administer a fully competitive HOTC program in order to build the greatest quantity of quality housing possible. A statistical analysis by the U.S. General Accounting Office (GAO) found that there is a better than 85 percent chance that for-profit developers will build LIHTC rental properties (the model program for the HOTC) at lower cost than tax exempt developers. It should be noted that tax exempt developers now are awarded approximately 32 percent of the Low Income Housing Tax Credit (LIHTC) awards for rental property developments. As a result they can be expected to have a very substantial involvement in the HOTC program without a federal preference.

NAHB believes that the HOTC is a needed compliment to the LIHTC program. The LIHTC program serves residents that are at 60 percent or less of area median income (AMI). The HOTC program would serve homebuyers at 80 percent or less of AMI. As tenants move up in income and establish a credit rating, they need the option of moving into their own homes and start building equity capital for themselves. The HOTC provides this opportunity.

The complimentary relationship between the two credits is clearly illustrated in their administration. The two credits have separate allocation pools for agencies to use in allocating the tax credits to the two different types of property. State agencies can offer different rates of return to investors to reflect the structural differences between the credits. The LIHTC is paid over a 10-year period to investors. The investors are subject to a recapture of their tax benefit if property is not used as a low-income rental property during a 15-year compliance period. The HOTC is paid out over a five-year period to the developer or investors who own the property prior to its sale to a qualified buyer. After the sale, only the buyer of a HOTC home is subject to a possible recapture or loss of tax benefits if the property is sold or converted to a rental property during the five-year credit period. As a result of the differences between the credits, there is more risk associated with investments in the LIHTC than the HOTC. Rates of return are expected to reflect the risk differences.

None of the nearly 30 national associations supporting the HOTC legislation in the Homeownership Tax Credit coalition want to advocate any proposal that would have adverse long-term harm on the LIHTC. It would be contrary to many of the organizations' fundamental interests because they are stakeholders in the rental credit program. Coalition partners who are investors believe that the equity market for housing is large enough to support efficient tax credits for both rental and ownership housing. In fact they issued a public statement to that effect. For example, the rental credit market remained very strong during the past two years despite declining corporate earnings among many corporate investors and a 40 percent increase in available credits.

First-Time Homebuyers' Tax Credit

NAHB supports a bill recently introduced by Senators Debbie Stabenow (D-MI), Gordon Smith (R-OR) and Mark Dayton (R-MN), the "First-Time Homebuyers' Tax Credit Act of 2003" (S. 1175) that would create a first-time homebuyer tax credit for low- and moderate- income homebuyers. The bill proposes to create a refundable tax credit of $3,000 for single taxpayers and

$6,000 credit for married couples buying their first home. The credit could be assigned during the purchase negotiations to cover purchase, financing or closing costs incurred by the buyer. The credit can only be claimed once and is subject to an income phase out starting at $67,700 for single taxpayers, $96,700 for heads of household, and $112,850 for joint returns, with a dollar-for-dollar phase-out of the tax credit beyond the cap.

NAHB is one of the original organizations supporting the bill. We believe the legislation will help mitigate the major hurdles most American's face when buying their first home – having a sufficient down payment and covering closing costs. The proposal also compliments the HOTC program. It has been estimated that the program would help as many as 17 million people become homeowners over the next seven years.

Tax Deductibility for Mortgage Insurance Premiums and Guarantee Fees

NAHB supports legislation introduced in the House of Representatives and the Senate that would make premiums paid for FHA and private mortgage insurance (PMI), and guarantee fees paid for Department of Veteran Affairs (VA) and Rural Housing Service loans tax deductible. The deduction for the fees is phased out for families with annual incomes greater than $100,000. Lower and moderate income homebuyers are the most frequent users of the insurance. Higher income families have alternative financing mechanisms that can be used in lieu of insurance. The deduction would result in an estimated revenue loss of $228 million over five years and $553 million over ten years.

Senators Gordon Smith (R-OR), Blanche Lincoln (D-AR) and Wayne Allard (R-CO) introduced S. 846, the "Mortgage Insurance Fairness Act". An untitled bill to provide a tax deduction for mortgage insurance and other similar expenses (H.R.1336) was introduced by Representatives Paul Ryan (R-WI), William Jefferson (D-LA), Clay Shaw (R-FL), John Lewis (D-

GA), Philip English (R-PA), John Tanner (D-TN), Mark Foley (R-FL), Eric Cantor (R-VA), Bob Ney (R-OH), Mark Green (R-WI), Robin Hayes (R-NC), George Radanovich (R-CA).

The provisions of S. 846 were added as an amendment to H.R. 2, the "Jobs and Growth Tax Relief Act of 2003" in the Senate Finance Committee mark up of the economic stimulus legislation and was passed the by the full Senate. Unfortunately, the provision was not reported out of the conference committee that resolved the differences between the House and Senate bills.

Currently, an estimated 7 million-plus homeowners pay premiums on FHA-insured mortgage loans and another 5.5 million pay private mortgage insurance premiums. Making mortgage insurance tax deductible would save FHA and PMI borrowers about $200 a year, while VA borrowers would receive a one-time benefit of $700. The proposed legislation would lower the after-tax cost of mortgage borrowing enough to enable 300,000 additional renters to buy a home.

American Dream Downpayment Initiative

NAHB supports the "American Dream Downpayment Act," which has was introduced in the Senate as S. 811 by Senators Wayne Allard (R-CO) and Jeff Sessions (R-AL). Representative Katherine Harris (R-FL) introduced a companion bill (H.R. 1276) in the House along with 31 cosponsors. The bills provide $200 million to assist lower-income families in achieving homeownership. This legislation targets funding under the HOME Investment Partnerships Program specifically to lower-income families seeking to purchase a home. The funds flow through the existing HOME block grant framework to state and local governments for programs providing downpayment and closing cost assistance. The program is expected to assist 40,000 households each year.

While we strongly support the intent of this legislation, NAHB has concerns with the proposed funding source. We believe that appropriations for the program should be above and beyond the funding appropriated for the HOME program, and not a set-aside within HOME's budget. NAHB is an ardent supporter of the HOME program, which is a vitally important source of gap financing supporting affordable housing production in conjunction with the Low Income Housing Tax Credit program, tax-exempt bond financing, and other state and federal affordable housing programs. In addition, HOME program already funds a significant portion of homeownership assistance efforts. NAHB has enthusiastically endorsed proposals to further increase HOME funding in the FY 2004 budget and feels additional funds, outside of HOME, should be allocated to support the "American Dream Downpayment Act."

FHA Modernization

Federal Housing Administration's (FHA's) single family insurance programs are vital to the housing finance system in serving borrowers and homeownership needs not addressed by the private sector. FHA has become increasingly less effective and efficient, however, as statutory and regulatory restrictions, as well as the constraints of the HUD bureaucracy, have caused FHA to lag behind the pace and standards set in the conventional housing finance industry. FHA is hamstrung by substandard operating and information systems and a short-handed and inexperienced workforce. As a result, FHA is not able to respond promptly and appropriately to developments in the mortgage marketplace or to foster innovations in housing finance products and programs. These problems are most severe in the area of new home production.

To regain its role as an effective and innovative leader in the affordable housing finance arena, FHA must gain greater autonomy from bureaucratic and political influences. FHA's mission should continue to focus on supporting liquidity, innovation and continuity in the housing finance markets, and on supporting financing needs not adequately addressed by the private sector, through the provision of mortgage insurance representing the full faith and credit of the U.S. government. However, FHA should have the authority, without further Congressional action, to create or alter specific insurance programs in order to have the flexibility to react promptly to changes in market and other conditions. Hiring, salaries, personnel management, and procurement would be freed from current, confining federal government constraints in order to be more consistent and competitive with the private sector.

FHA insurance of construction loans

One area where FHA can add significant value is through insurance of single family construction loans. Most builders, particularly smaller companies (those building fewer than 500 homes a year), which account for about three-quarters of annual new home production, must rely exclusively on insured depository institutions (mostly commercial banks) for construction credit. There is no secondary market to attract new lenders and investors to this market. The development of such a market will lower the cost of construction credit, help attract more capital to underserved areas and help home builders avoid the type of severe credit crunch that occurred in the early 1990s. In addition, the availability of secondary market liquidity support would assist current market lenders, many of which are restricted by loans-to-one-borrower limits required by federal banking statutes.

Availability of FHA insurance for home construction loans would enhance efforts to find secondary market outlets by opening up the Ginnie Mae program to issuers using housing production collateral. FHA has a construction-to-permanent mortgage insurance program, which is currently inactive. Under this program FHA does not insure the construction segment of the loan. There is clear precedent for this on the multifamily side where FHA insures construction loans that convert to permanent mortgages.

<u>*NAHB Regulatory Priorities*</u>

Fannie Mae and Freddie Mac Housing Goals

Fannie Mae and Freddie Mac are required by law to meet annual housing goals established by HUD. The goals compel Fannie and Freddie to purchase loans on affordable homes, including those in underserved markets such as high-minority and low-income census tracts. Revisions to the goals for the years 2004 –2006 are currently under review by HUD.

The housing goals track the firms' purchases of mortgages for low- and moderate-income people (the low/mod goal); loans in underserved geographically targeted areas (the geographically targeted goal); and, mortgages for very-low income people and neighborhoods (the special affordable goal).

The Administration's 2004 budget analysis suggests that HUD may incorporate new factors into the housing goals to spur increased minority homeownership rates. Senior HUD officials have requested input from the housing industry in the development of new housing goals.

NAHB is a strong supporter of the affordable housing goals for Fannie Mae and Freddie Mac. The goals have encouraged Fannie and Freddie to reach deeper into the affordable housing market with tangible benefits. NAHB supported HUD's increase in the goals for the 2001 – 2003 period, from the original goals put in place in 1995. NAHB feels that more needs to be done to encourage the GSEs to increase their activities in some market segments, such as rural areas and multifamily production.

At the same time, proposed changes to the housing goals should undergo careful examination. NAHB believes that Fannie Mae and Freddie Mac were created to serve a broad range of housing needs and we would not want overly stringent goals to impede that mission. Additionally, continual increases in the percentage targets will have diminishing returns and run the risk of adversely impacting other housing programs, such as FHA's single family program. The Mutual Mortgage Insurance Fund that backs the FHA program relies on a cross subsidization of loans within the program for ongoing self-sufficiency. FHA has been experiencing higher default experience in recent years as Fannie Mae and Freddie Mac have captured more of the better performing loans in the first-time home buyer, lower-income part of the market. Excessive housing goals for Fannie Mae and Freddie Mac would exacerbate this trend and could have damaging effects on the FHA fund.

Efforts to Remove Homeownership Barriers

NAHB Efforts

NAHB is firmly committed to removing barriers to affordable housing. NAHB and its more than 800 state and local affiliates have been active at the federal, state and local level, working with law makers to identify policies and bureaucratic hurdles that make it difficult to build affordable housing or that add to the cost of such housing.

Representatives of NAHB and its affiliates have met with legislators and regulators at all levels of government to explain how these barriers can be removed without compromising the quality of development. NAHB has also been active in demonstrating the negative effects of not-in-my-back-yard (NIMBY) resistance to infill development, and in working for federal and state legislation to encourage cleanup and redevelopment of brownfield sites.

At the federal level, NAHB has been one of the strongest proponents of reform of existing brownfields redevelopment laws that fail to provide adequate liability protections for private sector firms seeking to clean and redevelop brownfields sites.

At the state level, NAHB's affiliates have worked with state legislatures and regulatory agencies to encourage policies that provide incentives for the production of affordable and eliminate excessive fees and regulations that drive up the cost of housing and price hundreds of thousands of families out of home ownership.

NAHB's local affiliates have been working with local elected officials and planning agencies to revise zoning and development regulations that discourage innovative land use practices such as mixed-use developments, cluster developments and higher-density housing near mass transit facilities.

Partnership Efforts

NAHB is actively working to facilitate affordable housing partnerships involving our federation of state and local home builders associations. We have ongoing partnerships a many areas of the country, including Lincoln, Nebraska; Nashville Tennessee; Albuquerque, New Mexico; Fresno and Sacramento, California; San Antonio, Texas; Pittsburgh, Pennsylvania; and, Portland, Oregon.

Our most recent initiative involves a partnership with Nueva Esperanza, a major Hispanic faith-based community development corporation, to build affordable housing in several cities across the United States. The first of these is taking place in Orlando, where NAHB, Nueva Esperanza and Esperanza USA are working to achieve the affordable housing production goals of the Hispanic Capacity Project in Mid-Florida.

Nueva Esperanza and its affiliates have an outstanding record of developing and operating successful programs addressing a wide range of needs of Hispanic households. NAHB looks forward to a partnership with Nueva Esperanza in the home building efforts of the Hispanic Capacity Project. Through the Orlando Project, the partners hope to develop a model for community partnerships that can be used to address affordable housing needs throughout the country.

Within the partnership, NAHB will:

- Work through NAHB's federation of more than 800 state and local home builders associations to identify home builders with interest and expertise in affordable housing production and encourage their participation in the Hispanic Capacity Project.
- Provide information to NAHB's members on the benefits of affordable housing partnerships and information and technical assistance on available financing programs and approaches as well as on innovations in design and building materials and techniques.
- Participate in communication and education efforts with communities and prospective home buyers.
- Assist in identifying and involving financing resources.

Conclusion

Mr. Chairman, thank you for the opportunity to present testimony to the committee on the issues of concern to home building industry during Homeownership Month. We appreciate being able to focus attention on ways to increase homeownership in the United States. Although the home building industry has been a key to the national economy, we believe the proposals we support are needed to bring the benefits of homeownership to the largest possible segment of the our population. NAHB looks forward to working with you, as well as the other members of

Congress and the administration in making the dream of homeownership come true for as many people as possible. Thank you again.